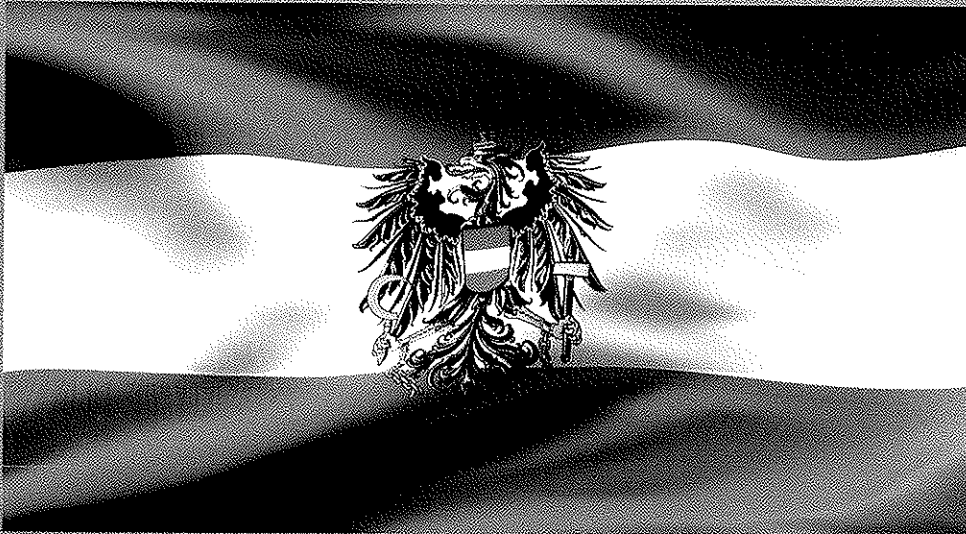


Austria-CEE

# Volte face



FOR MORE THAN 10 YEARS AUSTRIAN LAW FIRMS MADE HAY WHILE THE SUN SHONE ON THE POST-SOVIET UNION ECONOMIES OF CENTRAL AND EASTERN EUROPE. BUT, REPORTS JONATHAN AMES FROM VIENNA, THE PARTY IS FINISHING AND EYES ARE TURNING WEST AGAIN

When the Berlin Wall began to crumble in late 1989 and the Iron Curtain was torn down shortly after, western politicians and human rights campaigners from both sides of the divide celebrated with unbridled joy the demise of European communism and the discrediting of centralised command economies. But no group rubbed their hands with more anticipation of boom times to come than the cadre of leading business lawyers in Austria.

And the boom did come. It took several years to clear the metaphorical rubble of around two generations of authoritarian rule, but by the mid-1990s the central and eastern Europe (CEE) region was buzzing with foreign investors looking to cash in. Lawyers to service those clients weren't far behind and leading the pack was a small but motivated band of Austrian practices that began planting their flags in regional capitals.

Austrian law firms very much view the CEE as their manor. It is almost as though the last 100 years or so haven't happened, the Habsburg's are still on the throne and the Austro-Hungarian Empire calls the tune for that part of Europe. As one partner at a leading business firm puts it, only partially joking: 'This is our market. We simply ignore what has happened since the First World War.'

#### On the march

For a good decade at least, it seemed as though a new commercial Habsburg empire was on the march. Austrian business law firms have opened outposts in Prague, Budapest, Warsaw, Bucharest, Bratislava, Sofia, Ljubljana, Tirana, Zagreb and even far flung Chişinău in Moldova, a country that most international lawyers – even those in Europe – would struggle to pinpoint on map. Between 1995 and 2007 Austrian law firms had their eyes firmly-focused east.

But that fixation could coming

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## Austria

Population: 8.4 million

Capital: Vienna (population: 1.7 million)

Currency: euro

World Bank's ease of doing business ranking: 31<sup>st</sup> in 2010; 32<sup>nd</sup> in 2011

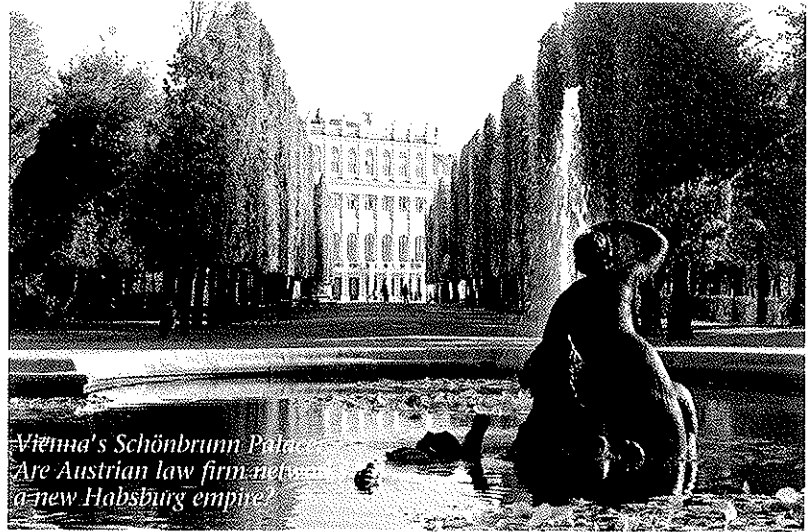
to a sudden halt as Austrian firms perform a dramatic volte face and realign the energies back to the west. Senior practitioners in the region say today that the global financial crisis – while causing little more than ripples domestically in Austria – has severely impacted on the CEE region with investment and growth in some countries almost drying up entirely.

That view is a slight generalisation. Poland, for example, the region's most populous country, remains strong economically, not having slipped into recession during the global economic storm. But Poland is a tough market for foreign law firms – it has top quality local practitioners and is already, maintain some, 'over-lawyered' in terms of regional and global firms.

### Losing the magic

Hungary is arguably at the other end of the spectrum. Beset by economic and political turbulence – and a government that appears hell bent on taxing foreign investors until they squeak and turn tail – few lawyers have a positive view of the jurisdiction's short to medium-term prospects. The Czech Republic finds itself somewhere in the in the middle. Hit badly by the economic storm of 2007-09, the jurisdiction has seen some high-profile withdrawals from Prague by major global law firms, not least Paris-based Gide Loyrette Nouel, which has retrenched its CEE operations, oddly, in Budapest (see p22).

If the Austrians need any encouragement to feel nervous about the region, they need look no further than the behaviour of the London magic circle practices. Linklaters has



Vienna's Schönbrunn Palace. Are Austrian law firms networking a new Habsburg empire?

effectively abandoned the region (apart from its Warsaw outpost) after Freshfields Bruckhaus Deringer arguably triggered the departures, leaving Hungary in 2007 (the Anglo-German firm now only maintains a CEE desk in London); Clifford Chance remains in Prague, Bucharest and Warsaw, but the firm made a high-profile withdrawal from Hungary in June 2009; only Allen & Overy retains a significant regional presence, with offices in the Czech and Slovak Republics, Hungary, Poland and Romania.

Suggestions are rife that the Vienna firms that have planted flags around the CEE are indeed beginning to feel less robust about the region, although all deny that they have over-extended their reach. Still the market buzzes to rumours that the regional practices are in some cases down by as much as half in terms of their fee-earning staff allocated to those offices.

But apart from the financial crisis, there have been other pitfalls in creating rapidly expanding regional networks. Comments Ferdinand Graf, the partner heading the mergers and acquisitions and competition group at Vienna and Graz-based Graf & Pitkowitz: 'Expansion by Austrian firms to the east in the 1990s was very successful at the outset, but ultimately they ran into quality problems in getting

enough manpower to do the work. It is difficult, for example, for an Austrian lawyer to be able to check on the work of, say, a Romanian lawyer. There is a language problem to start with.'

Communication is not the only difficulty afflicting Austrian regional law firms. 'Those firms that set up offices to become pan-CEE law firms focused those offices on doing transactional work,' says Christian Dorda, senior partner of Dorda Brugger Jordis, a firm exclusively based in Vienna. 'But now when confronted with courts and local authorities in relation to restructurings – sometimes involving a fight for survival – you need firms that are well established and familiar with those local authorities. That means that the local firms in those countries now have a more attractive proposition for clients.'

### Costly networks

Ultimately, says Mr Graf, the financial crisis has caused the biggest headaches. 'Over the last two years those networks have cost those firms. They built up the offices but they have not had the work to feed them. Some lawyers have tried to spin-off to get out of the Austrian network. And because they have built a reputation for being able to do international work, they will be able to attract instructions because their fees will be lower

than those of the Austrian firms.'

Mr Graf predicts that it is entirely possible that 'we may see some Austrian firms following the magic circle practices out of parts of the CEE. They might be forced to do so by their local lawyers who will want to be partners and may take a decision to spin off if they are not made up'.

Raoul Hoffer, the managing partner of another exclusively Austria-based independent

law firm, Binder Grosswang, is equally blunt: 'Five years ago I would have seriously considered opening offices in the region, but now I have no hesitation in saying no.' He gives two reasons for that trenchant view: 'The financial crisis illustrated the inflexibility of a big network. Having offices everywhere can work against you because of the costs of keeping them running in a hard market. Also if you look at the forecast for the growth of the

CEE countries, it is estimated to be 2 to 3 per cent – which is not bad, but is far from the 7 to 8 per cent of the boom years.'

Perhaps predictably, the founding partner of a law firm that has recently spun off from one of the region's biggest players is the most damning. Alfred Nemetschke broke away from regional giant Schoenherr last September to create Nemetschke Huber Koloseus. His view of the prospects of his

## Czeching in

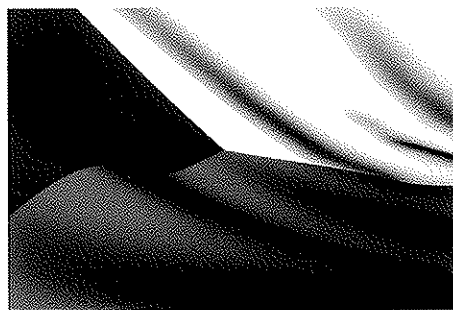
Cautious optimism is the phrase permeating Prague's leading independent business law firms. Last year didn't start well, not least because of political uncertainty around the country's elections; but the mood changed in the second half of 2010 as a general election produced a swiftly formed government that has presented a positive attitude towards businesses and is interpreted as being prudent with its budget.

'We don't see ourselves going the way of Greece and Ireland,' comments Martin Solc, senior partner of leading law firm Kocian Solc Balastik. Indeed, the banking crisis that has so crippled some important European jurisdictions was not a factor in the Czech Republic, where the local financial institutions remain strong.

At the heart of the relatively positive outlook is the robust recovery of the German economy. Germany is the Czech Republic's main export market and the country as a whole is highly export dependent. Indeed, it is the biggest motor car manufacturer in Europe, with many tangential industries reliant on the success of that sector.

Solar energy projects were also buoyant in the country last year, but warns Radan Kubr, a banking and M&A partner with leading Prague firm PPK Partners, that market is scheduled to cool soon. 'This work will slow down because the government has introduced restrictions and a tax on the revenues from those projects,' he says.

In the Czech Republic and other countries across Europe, governments guaranteed to a specific level the purchase price of the energy produced



**Leading law firms in the business sector maintain they don't feel threatened by competition from their Austrian counterparts, although they acknowledge the regional firms tend to drive up associate salaries**

by solar projects, making investment highly attractive. Ultimately, investment volumes were much larger than expected, which has forced governments to react, although, some, such as the Spanish and French, have been quicker off the mark than the Czechs.

Generally, the leading independent law firms in the business sector maintain they don't feel threatened by competition from their Austrian counterparts, although they acknowledge that the regional firms tend to drive up associate salaries.

'We don't see the Vienna firms as a current threat,' maintains Mr Kubr. 'Their strategy has been to open smaller offices to serve predominantly

Austrian clients, although that approach may be gradually changing. But currently in the Czech Republic or Slovakia we still view them as second tier players. Their position is improving and their visibility is growing. But they must have problems getting the brightest lawyers to join. Most young lawyers would prefer to work for global law firms because there has been a bias on the part clients in favour of global law firms. But that is diminishing as they realise they can get the same level of quality service from local firms at better value.'

Some of those globals have had their own problems in the Prague market, with commentators suggesting that four-day working weeks were not unheard of during the financial crisis. And some have bailed out completely, most notably London-based Linklaters – whose departure created local firm Kinstellar – and Paris-based Gide Loyrette Nouel. Mr Solc confesses to be slightly flummoxed as to why the English lawyers jumped ship, as he maintains that the market view of the Linklaters' office was that it continued to be profitable. 'I think it was a mistake for them to close,' ponders Mr Solc. 'Perhaps they wanted a high-profile closure to send a message to the rest of the firm's network.'

As far as Gide is concerned, the French departure saw about six of its lawyers joining PPK. Remarks Mr Kubr: 'I can't comment on why Gide gave up on Prague – it is probably part of a wider strategic decision. My understanding is that the firm viewed the Czech market as too small for an international law firm to thrive.'

Nonetheless, others remain – Clifford Chance, White & Case and Allen & Overy all have high reputations in the country.

former practice and its major competitors across the CEE? 'It is a real disaster. They haven't reduced their costs as quickly as they should have done. And they are under heavy pressure to reduce fees. That is a lose-lose position. These firms are no longer able to offer a positive future to their young lawyers and as a consequence those people leave.'

#### Finding friends

Those Vienna-based firms that have opted for a strategy of not opening offices in the CEE generally employ a 'best friends' or 'good friends' approach to the region, forming generally non-exclusive ties with local practices in the various jurisdictions. Partners at these firms maintain the economics are simple – they can still earn good profits on hourly charge-out rates of little more than €250, while, they

**'They haven't reduced their costs as quickly as they should have done. And they are under heavy pressure to reduce fees'**

*Alfred Nemetschke, Nemetschke Huber Koloseus*

suggest, the Austrian regional firms must get between €350-€400 per partner hour to be in the black.

It is that basic equation, claims one leading Vienna-based law firm partner, that has triggered significant restructuring programmes at the regional offices of some of the big Austrian practices. He says firms have in some cases dropped between a third and a half of their fee earners at those offices. Nonetheless, he doesn't envisage them giving up. 'Austrian firms will do everything to maintain their presence in the CEE

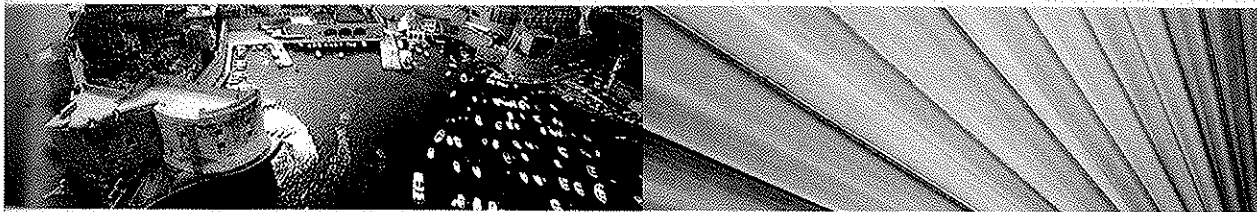
countries,' he says.

And indeed, the big CEE players aggressively defend their regional strategies. 'It has paid off for us and other firms to have a strong foothold in those countries,' says a bullish Eric Steger, recently installed to the three-strong managing partner team at Wolf Theiss. The firm currently has outposts in 10 CEE jurisdictions and is actively eyeing up Warsaw this year.

Mr Steger candidly comments that he doesn't 'envy those firms that have just purchased offices in the region in the last two years'. And he is slightly guarded about Wolf's most recent expansion, moving farther afield from the CEE to Ukraine by opening in Kiev in 2009. 'Whether that was a smart move is a good question,' he acknowledges, 'Although we don't regret it. When you start to look at a market and a team to

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## Hunger pangs

At first glance, the decision by French global law firm Gide Loyrette Nouel to pack its bags in Prague (and Belgrade) and head for the Hungarian capital of Budapest is bewildering at best.

The Czech economic picture, while not glowing brightly, is at least thought to be improving. Which is considerably more than lawyers generally are saying about Hungary, where the government has imposed a high corporate tax regime and exhibited broader worrying tendencies, such as implementing a draconian media law that clamps down on free speech.

The Gide partner in charge of the Budapest office, Francois d'Ornano, acknowledges that 'the economic situation remains difficult', but he defends the consolidation in Hungary. 'Our strategy is to have a strong base in Budapest with a very good local team,'

## The government has imposed a high corporate tax regime and exhibited broader worrying tendencies

he says. 'In the last nine months I have almost totally renewed the team with the arrival of 80 per cent new lawyers.'

Indeed, Gide has been raiding its international competitors to boost its Budapest operations, luring lawyers from Clifford Chance, Linklaters and Cameron McKenna. 'We now have one of the strongest teams on the market with about 20 lawyers,' maintains Mr d'Ornano. 'We have people in that team who are used to working on cross-border mandates. We put money on the table to attract the best people.'

assemble, you need a lot of time. And it is difficult to write off all the time and money invested in assembling and researching that team and market. We decided to take the risk and open.'

However, he is adamant that the approach of boots on the ground across a wide CEE network has been right for his firm. 'We are committed to the region. And the fact that some magic circle firms and others have left these markets is helpful for us because ultimately we cannot really compete with those practices. Now we hope to be a regional referral partner for those magic circle firms. We can bring in the quality they need in more than one country.'

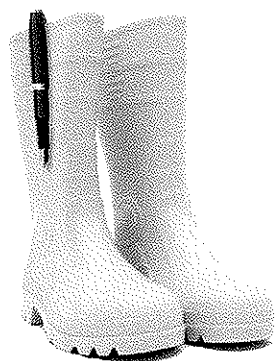
### Risky approaches

ENWC is another Vienna firm with CEE offices in Warsaw, Prague and Brno in the Czech Republic and in Bratislava. Corporate partner Raimund Cancolo claims the firm maintained its numbers in the region during the crisis, but it put on hold plans to expand further into Bucharest and Sofia. 'We adopt a very conservative and considered approach,' says Mr Cancolo. 'When we open in another country, it is unthinkable that we'll pull out. Others take a more risky approach.'

However, he maintains that with the economic outlook improving – driven mostly by a resurgent Germany – expansion for his firm is back on the agenda, with the practice probably moving into Bulgaria this year or in the first quarter of 2012. However, he says, 'Romania is more of a problem – there is not much industry and the money we'll make there will be in the real estate sector. But we are seeing some US real estate investors coming back to that country.'

Another regional powerhouse is Schoenherr, which runs nine full offices in the CEE and five regional desks. Managing partner Christoph Lindinger is convinced that the firm is not over-extended in the region. 'We

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haven't cut back our offices,' he maintains. 'To the contrary, we've expanded into Turkey – and after the first six months that appears to be one of our best ever moves.'

Of course, Turkey is not in the CEE, so what is Mr Lindinger's position regarding the firm's doorstep region? 'Our numbers in Eastern Europe may have gone down a bit, but we didn't go through a redundancy programme and the numbers are not down by more than 10 per cent.'

He is adamant that 'the regional firm model is justified in markets where the domestic market is not full of strong local players and it is not one of the world financial centres. The CEE is a recognised region and as a whole it is not over-lawyered, despite some concentrations in places such as Warsaw.'

### Long-term players

Schoenherr, says Mr Lindinger, is the quintessential example of a long-term player. The firm, he predicts, will capitalise on investment that is moving back into the CEE as the economic integration of those economies begins to reach what he maintains will be the levels seen in the Benelux states. 'And why shouldn't they integrate?' he asks. 'Once they do, the percentage of cross-border work will increase and the multi-jurisdictional firms that can offer the one-stop-shop service will have a clear competitive advantage. It is a long-term strategy and therefore we are not looking to be dependent on booms.'

Illustrating that commitment to the region, says Mr Lindinger, is the firm's recent decision to broaden its partnership beyond the boundaries of Austria. At the beginning of the year, Schoenherr invited its first five non-Austrian partners – from Czech Republic, Serbia and Romania – into the equity. 'A regional firm must have regional ownership, so this is the beginning of a strategy,' comments the managing partner.

**'The global crisis was not that bad in Austria. It could have been worse'**

*Christian Dorda, Dorda Brugger Jordis*

'In the longer term we expect that the economic weight of the firm will slightly shift away from Austria and that could possibly be reflected in the composition of the partnership.'

Back home, the hallmarks of the domestic Austrian market are conservatism and an integral link to the massive German economy. According to Christian Dorda: 'The global crisis was not that bad in Austria. It could have been worse, but thanks to several rescue measures we went more smoothly through the crisis than did other jurisdictions. Also, consumer behavior didn't change very much, although there has been a widening of the gap – the opening of the scissors, as we say here – between the rich and the poor.'

While Mr Dorda predicts the CEE will continue to be important to Vienna law firms,

its position will gradually lessen. 'Large domestic Austrian business law practices are looking more to the west now than previously. That doesn't mean that we are no longer a hub for the CEE region – that continues. But now the story is about restructuring and advising banks in the region, which have to adapt to a lower demand in those countries.'

Mr Dorda's partner Martin Brodey maintains that while 2010 started slowly in the Austrian market, the M&A sector began to pick up later in the year. Now, he says, the market is 'not so much financially driven, but we are seeing strategically-orientated M&A deals. Companies that are finding complementing enterprises that fit together with an overall business strategy.'

Peter Polak, head of the

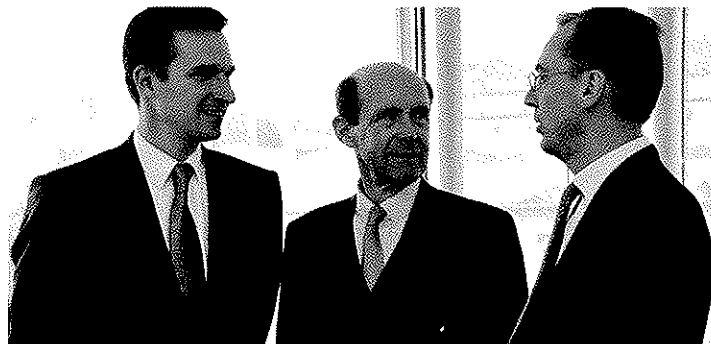


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## Tough times in Zagreb

With a population of no more than 4.5 million (about half that of Austria), Croatia is one of the smallest countries in the CEE region, but it is still attracting international law firm attention. Two big Vienna players are on the ground (Wolf Theiss and Schoenherr), as are a couple of Anglo-US global practices, DLA-Piper and Hogan-Lovells.

They may well be wondering what brought them to the country, which is only about 15 years into its hard-fought traumatic battle for independence. Boris Babic, senior partner at local Zagreb firm Babic & Partners, describes the country's current economic situation as 'not good'. Comments Mr Babic, who launched his firm a year before the end of the war between the

Croats and Serbs: 'The most notable problems are that growth is very sluggish. Croatia is facing huge unemployment, large foreign debt and a general budget deficiency. While some countries are facing a double dip recession, Croatia is facing at least a triple dip.'

However, there are some positive notes. The financial and banking system – which is 95 per cent foreign owned – is generally thought to be stable with significant reserves. Croatia is also eagerly anticipating accession to the EU – negotiations finish this June – a move that local business lawyers say should provide a boost to the ailing economy.

Mr Babic says the local legal profession is fairly advanced, but firms struggle to recruit high quality



local graduates. 'It is always difficult to find top people. We target students that have not only good grades but have been exposed to international environments – post-graduate diplomas from the elite international universities. In our own education system, there is not enough emphasis on European law, competition law and general business law.'

international and corporate department at Fiebinger Polak Leon, points out that, similar to other European jurisdictions, corporate general counsel are applying pressure on professional fees in Austria.

'During the financial crisis we have seen clients becoming much more cost conscious,' he says. 'They are reluctant to have three associates in the room for meetings. So there is a cost advantage from the client's point of view of coming to a firm such as ours where you get direct access to the partner and not a herd of associates.'

Mr Polak agrees that deals are returning to the Vienna market, but at a small to mid-market level of between €10 million to €180 million. 'Everybody is buying everything,' he enthuses. 'It was as though everyone had been sitting and waiting.'

And he maintains that mid-sized Austrian-based independent firms are best placed to pick up the new instructions. 'I had a conversation with a magic circle lawyer the other day who said I've got a team of corporate lawyers who are all very good, but they are used to thinking in really big numbers. How do

## Part of that German failure in the region is historical, with the country rightly or wrongly still being viewed with suspicion

I motivate them to do smaller deals? It is extremely difficult. And I think clients can feel that.'

Surprisingly, the one jurisdiction Austrian law firms tend to ignore is their large neighbour to the north-west – especially considering that the greatest amount of immigration to the country comes from Germany. Apart from making the odd joke self-deprecating quip about Germans helping to improve Viennese language skills, Austrian business law firms see little threat from German practitioners either locally or in the region.

'The German firms are not interested in the Austrian domestic market because in the grand scheme of things it is Mickey Mouse,' comments ENWC's Raimund Cancolo. 'It is interesting as a gateway to the east, but the Germans reckon they can go directly to the Eastern European market. However, their law firms are not

that successful in doing so.'

Part of that German failure in the region, claim the Austrians, is historical, with their country rightly or wrongly still being viewed with suspicion by Eastern Europeans. And domestically, the Austrian banking sector has not interested its German counterparts.

Mr Cancolo explains: 'The Austrian financial sector hasn't been that clever in the past and not sufficiently ambitious to get involved with some of the more complex financial instruments. Austrians are generally conservative and very pessimistic by nature.'

But that conservatism has had its benefits. 'The Austrian banks have been more careful in the past than, say, banks in Germany or the UK,' says Mr Cancolo. 'And the sub-prime problems that washed over from the US and hit banks in the UK, Germany and Switzerland, did not really have that much of an impact on Austrian banks. Austria expected the crisis to be much worse domestically than it was. Industry was prepared for large lay-offs, but in the end they weren't necessary. But I'm not sure we know yet just how bad things have been in the CEE.'